

Legislative Audit Division

State of Montana



Report to the Legislature

October 2006

Financial-Compliance Audit **For the Two Fiscal Years Ended June 30, 2006**

Department of Revenue

This report contains seven recommendations to the department. Issues addressed in the report include:

- ▶ **Financial Accountability**
 - Reconciliation controls
 - Unrecorded revenue and expenditures
 - Debt collection program
- ▶ **Improving tax compliance for:**
 - Combined oil and gas severance taxes
 - Corporation license taxes
 - Individual income taxes
- ▶ **Noncompliance with state statutes**

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Government Auditing Standards, the Single Audit Act Amendments of 1996 and OMB Circular A-133 require the auditor to issue certain financial, internal control, and compliance reports. This individual agency audit report is not intended to comply with these reporting requirements and is therefore not intended for distribution to federal grantor agencies. The Legislative Audit Division issues a statewide biennial Single Audit Report which complies with the above reporting requirements. The Single Audit Report for the two fiscal years ended June 30, 2007, will be issued by March 31, 2008. The Single Audit Report for the two fiscal years ended June 30, 2005, was issued on March 6, 2006. Copies of the Single Audit Report can be obtained by contacting:

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October 2006

The Legislative Audit Committee
of the Montana State Legislature:

This is our financial-compliance audit report on the Department of Revenue for the two fiscal years ended June 30, 2006. Included in this report are seven recommendations related to reconciliation controls, unrecorded revenue and expenditures, the debt collection program, improving tax compliance, and noncompliance with state statutes. The department's response begins on page B-3.

We thank the department's director and staff for their assistance and cooperation throughout the audit.

Respectfully submitted,

/s/ Scott A. Seacat

Scott A. Seacat
Legislative Auditor

Legislative Audit Division

Financial-Compliance Audit

For the Two Fiscal Years Ended June 30, 2006

Department of Revenue

Members of the audit staff involved in this audit were Pearl M. Allen, David Brammer, Jeane Carstensen-Garrett, Chris G. Darragh, Rick Eneas, Brenda Kedish, Delsi Plummer, and Vickie Rauser.

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Appointed and Administrative Officials

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David Hunter, Deputy Director

Brenda Gilmer, Acting Chief Legal Counsel

Division Administrators

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Department of Revenue

This report documents issues noted during our financial-compliance audit of the Department of Revenue (department) for the two fiscal years ended June 30, 2006. The seven recommendations in this report discuss reconciliation controls, unrecorded revenue and expenditures, the debt collection program, improving tax compliance, and noncompliance with state statutes. This report also contains one disclosure issue related to audit collections.

We issued a qualified opinion on the department's financial schedules presented in this report. The opinion on page A-3 discusses unrecorded expenditures for the Liquor Control Division. This means the reader should use caution when analyzing the presented financial information and the supporting data on the primary accounting records.

The listing below serves as a means of summarizing the recommendations contained in the report, the department's response thereto, and a reference to the supporting comments.

Recommendation #1

We recommend the department implement controls to ensure daily reconciliations of receipts to amounts recorded on its taxpayer systems are complete and accurate..... 11

Department Response: Concur. See page B-3.

Recommendation #2

We recommend the department record revenues and expenditures for local government reimbursements and collection agency contracts, as required by state law... 12

Department Response: Concur. See page B-4.

Recommendation #3

We recommend the department:

- A. Charge the General Fund a proportionate share of debt collection program costs for collecting child support debt.

Department Response: Partially concur. See page B-5.

Report Summary

- B. Adjust its delinquent account collection rate to be commensurate with costs, in accordance with state law.

Department Response: Concur. See page B-5.

- C. Move \$36,662 of fiscal year 2005-06 costs from the Internal Service Fund to the General Fund..... 15

Department Response: Concur. See page B-5.

Recommendation #4

We recommend the department work with the Board of Oil and Gas Conservation to develop and implement procedures for cross-matching oil and gas production and sales data to ensure all oil and gas severance taxes owed are reported or assessed in accordance with state law. 17

Department Response: Partially concur. See page B-6.

Recommendation #5

We recommend the department:

- A. Work with the Secretary of State to obtain the information necessary for an efficient comparison of new entity information.

Department Response: Concur. See page B-6.

- B. Compare information to department records for all of the entities the Secretary of State reports.

Department Response: Concur. See page B-7.

- C. Implement more effective procedures for identifying and reporting corporation license tax nonfilers and delinquent filers to the Secretary of State as required by state law. 19

Department Response: Concur. See page B-7.

Recommendation #6

We recommend the department:

- A. Comply with section 15-30-112, MCA, concerning the income limitation of dependents other than taxpayers' children.

Department Response: Concur. See page B-7.

- B. Improve the tax booklet by including all information affecting individual income tax computations contained in state law. 21

Department Response: Concur. See page B-7.

Recommendation #7

We recommend the department:

- A. Centrally assess cellular phone companies as required by section 15-23-101, MCA.

Department Response: Concur. See page B-8.

- B. Implement procedures and administrative rules to provide consistency in assessing additional penalties for purposely failing to file or pay taxes when due, as required by sections 15-1-216(1)(b) and (d), MCA.

Department Response: Concur. See page B-8.

- C. Seek legislation to amend sections 15-1-201 and 15-35-104, MCA, to reflect the department's current information needs from municipal corporations and coal mine operators. 23

Department Response: Concur. See page B-8.

Introduction

Introduction

We performed a financial-compliance audit of the Department of Revenue (department) for the two fiscal years ended June 30, 2006.

The objectives of our audit were to:

1. Obtain an understanding of the department's control systems and, if appropriate, make recommendations for improvement in the internal and management controls of the department.
2. Determine if the department complied with selected state and federal laws and regulations.
3. Determine the implementation status of prior audit recommendations.
4. Determine if the department's financial schedules fairly present the results of its operations for each of the fiscal years ended June 30, 2005, and 2006.

In accordance with section 5-13-307, MCA, we analyzed and disclosed the costs, if significant, of implementing the recommendations contained in this report. Issues deemed not to have significant effect on department operations have been discussed with management, but are not included in this report.

As required by section 17-8-101(6), MCA, we analyzed the fees and charges for services and the fund equity of the department's Internal Service Fund, which is used to provide bad debt collection services to state agencies. The statute requires fees and charges for services deposited in the Internal Service Fund be based upon commensurate costs. Based on our review (see page 12), we determined the rates were not commensurate with costs for the activity in the Internal Service Fund for fiscal years 2004-05 and 2005-06 and the fund equity at June 30, 2005, and 2006, was excessive.

Department Organization and Functions

The department collects revenue from and enforces regulations for over 30 state taxes and fees. Taxes collected include individual income, corporation, natural resource, accommodation, property, alcohol, and tobacco. The department also regulates the sale and distribution of alcoholic beverages in the state.

Introduction

The department was reorganized on November 17, 2005. The changes resulting from that reorganization are summarized in Note 6 to the Financial Schedules on Page A-15. As of June 30, 2006, the department was composed of 612.08 FTE in five divisions, with overall agency direction and management coordinated from the Director's Office.

The Business and Income Taxes Division (123.75 FTE) oversees audits and verifies compliance with Montana tax law for all state taxes, oversees state revenue collection activity, and completes appraisals and assessments of industrial and centrally assessed property. The division also seeks to return unclaimed property to its rightful owners.

The Citizen Services and Resource Management Division (25 FTE) provides service to Montana citizens, businesses and nonresident taxpayers through a call center, one-stop licensing, forms design and other taxpayer services. The division also provides service and support to the department in the areas of accounting, purchasing, and facilities and asset management.

The Information Technology and Processing Division (99.45 FTE) provides application development and support services, as well as network services in the areas of data, desktop, information security, and help desk support. The division also processes tax returns and payments for the department and for state agency partners.

The Liquor Control Division (25 FTE) administers the state's Alcoholic Beverage Code, which governs the control, sale, and distribution of alcoholic beverages. The division includes liquor distribution and liquor licensing.

The Property Assessment Division (298.85 FTE) is responsible for the valuation and assessment of real and personal property throughout the state for property tax purposes. The division is comprised of a central office located in Helena and six regional

areas. There is a local department office in each county seat within the regional areas.

The Director's Office (40.03 FTE) supports the agency's director and is composed of four work units. The basic function for each unit is:

Legal Services supervises the overall legal efforts of the department, which includes rules, policies, bankruptcy, the disclosure officer, and the Office of Dispute Resolution.

Tax Policy and Research is responsible for the preparation of legislative fiscal notes that affect revenue, the analysis of legislative proposals affecting the department, and department economic data and tax compliance analysis.

Human Resources manages the personnel activities of the department. The office includes three units: Human Resources, Payroll and Benefits, and Education and Training.

Executive Office includes budget analyst, public relations, and administrative support.

Advisory Councils, Boards, and Memberships

An Advisory Council for Multi-State Tax Compact was authorized by section 2-15-1311, MCA, to act in an advisory capacity to the multi-state tax commission member for Montana for the purpose of complying with Article VI, section 1(B) of the compact. That member is the department director or the director's designee. This council has no rulemaking or rule adjudicating authority.

The Agricultural Land Valuation Advisory Council was created by section 15-7-201(7), MCA, to advise the department concerning the valuation of agricultural property. This council must include a member from the Montana State University-Bozeman, College of Agriculture, staff. This advisory council is not a policymaking body and has no rulemaking authority.

Introduction

The Board of Review oversees the one-stop licensing program, as established in section 30-16-302, MCA, and is attached to the department for administrative purposes only. The board has separate rulemaking authority under section 30-16-104, MCA.

The department is a member of the Multistate Tax Commission, the Federation of Tax Administrators, the Western States Association of Tax Administrators, the National Alcohol and Beverage Control Association, and the National Association of Unclaimed Property Administrators. The department also participates in the following state government organizations: the Information Technology Board, the Electronic Government Advisory Council, the Information Technology Managers Council, the SABHRS Enterprise Solutions Council, and the Montana Geographic Information Council.

Department Reorganization and System Replacement

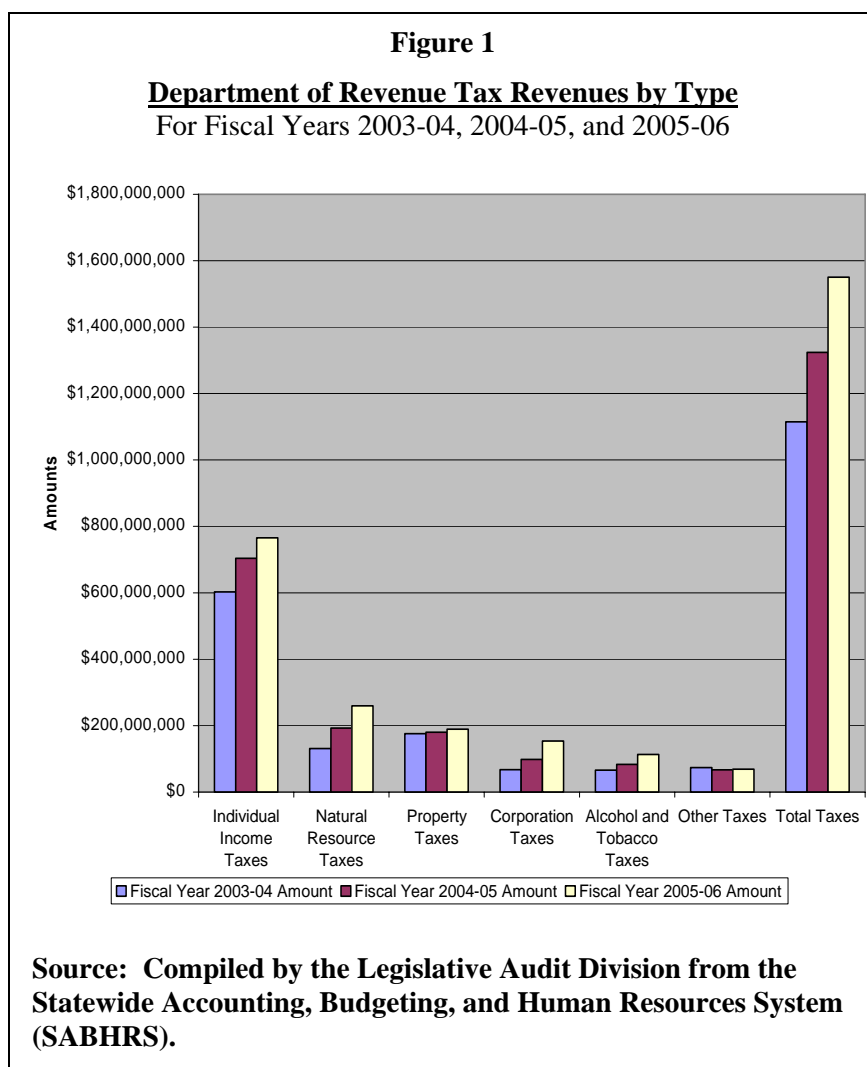
Chapter 597, Laws of 2003, provided that the state's Chief Information Officer and the Department of Administration work in conjunction with the Departments of Revenue and Labor and Industry to replace the Process Oriented Integrated System (POINTS). The legislation authorized funding for the Integrated Revenue Information System (IRIS) not to exceed \$17 million. The unemployment insurance tax collection and related transactions processed under POINTS transferred to the Department of Labor and Industry as of July 1, 2004.

The IRIS project consists of three phases. The initial phase of the IRIS project, completed in August 2004, included the implementation of a new rental vehicle tax and the migration of withholding, lodging facilities, cigarette, and combined oil and gas taxes from POINTS. The second phase of the project, completed in September 2005, encompassed conversion of corporate license and individual income taxes. The third phase of the project will convert the remaining miscellaneous tax and license programs to IRIS and allow the department to completely shut down POINTS. The third phase of the project began in the fall of 2005. Conversion from POINTS is expected to be complete by December 2006. At June 30, 2006, 20 revenue sources remain to be converted. Eleven

revenue sources are scheduled for conversion on October 2, 2006, and nine revenue sources are scheduled for conversion on December 11, 2006.

Tax Revenues

Tax revenues represented 83 percent of total revenues recorded on the state's accounting system for the department in fiscal year 2003-04, 82 percent in fiscal year 2004-05, and 85 percent in fiscal year 2005-06. Tax revenues by type, as recorded by the department on the state's accounting system for fiscal years 2003-04, 2004-05, and 2005-06 are illustrated below in Figure 1.



Introduction

Prior Audit Recommendations

The previous financial-compliance audit report of the department for the two fiscal years ended June 30, 2004, contained six recommendations. Of those, the department implemented three, partially implemented one, and did not implement two recommendations. The recommendations not implemented are related to timing of liquor payments and recording contracted collection expenditures as discussed below and on page 12, respectively. Issues related to the partially implemented recommendation regarding municipal corporations and distributions to local governments are discussed on page 23 and below, respectively.

Timing of Liquor Payments

In our past two audits of the department, we have discussed how the state statutes regarding timing of payments for liquor purchases effectively provide 30-day interest free loans from the state treasury to privately owned agency liquor stores at an annual cost in lost interest to the General Fund of approximately \$100,000.

Section 16-2-101(2)(b)(ii)(C), MCA, requires agency stores to pay for liquor they have purchased within 60 days from the date of purchase. However, section 17-8-242(2), MCA, requires the department to pay liquor suppliers for the liquor in 30 days or less from the invoice date. In our prior audit, we recommended the department seek legislation to require payments from agency liquor stores within 30 days, or to allow payment to liquor suppliers in 60 days. Our prior audit recommendation still applies. Another option would be to seek legislation requiring agency stores to pay interest for purchases not paid for in 30 days. The department should work with the legislature to resolve this issue statutorily.

Distributions to Local Governments

As noted in our prior audit report, section 15-1-113, MCA, requires the department to determine the amount of fee in lieu of property tax lost by each local government as the result of amendments to section 61-3-529, MCA, contained in Chapter 500, Laws of 2001. Section 61-3-529, MCA, pertains to a schedule of fees for buses, motor vehicles having rated capacity greater than one ton, and truck tractors. Section 15-1-113, MCA, also provides guidance for determining reimbursement amounts to be distributed via quarterly

payments to local governments. Department personnel indicated that there is no need to comply with this statute because section 15-1-121, MCA, requires the department to calculate each local government's base entitlement share of the state General Fund. This statute includes fee revenue in section 61-3-529, MCA, as part of the entitlement calculation.

There appears to be a conflict between the statutes as both involve calculation of reimbursements to local governments for lost property taxes. The department believes that section 15-1-121, MCA, superceded section 15-1-113, MCA, regarding payments made to local governments. In the prior audit, we recommended the department seek legislation to resolve the conflicts in these statutes. Our prior audit recommendation still applies. Because the department has been working with the Revenue and Transportation Interim Committee to develop draft legislation for the 2007 legislature, we make no further recommendation at this time.

Findings and Recommendations

Financial Accountability

State law requires the department to input all necessary transactions on the state's accounting system before the end of the fiscal year to present the receipt, use and disposition of all money, for which it is accountable, in accordance with generally accepted accounting principles. During the audit we reviewed various aspects of the department's controls for ensuring compliance with this requirement. Controls should be designed to safeguard assets and to effectively prevent or to detect and facilitate the correction of errors on a timely basis. We performed tests of transactions and analyzed financial activity recorded for the department on the state's accounting system to determine whether the department complied with this requirement. We noted the following issues related to financial accountability.

Reconciliation Controls

The department's reconciliation process did not adequately ensure tax payments received during fiscal year 2005-06 were properly recorded on the department's tax systems and the state's accounting system because the reconciliations were incomplete or contained errors.

The department's Processing and Retention Operations (PRO) unit processes over one billion dollars in receipts each fiscal year. Cashiering personnel in the unit are responsible for depositing receipts in the state treasury daily and for ensuring the amounts received each day are correctly posted on the department's taxpayer accounting computer systems, which interface with the state's accounting system. The accountants in the Citizen Services and Resource Management Division ensure the amounts posted to the department's computer systems for each month were also recorded in the proper revenue accounts on the state's accounting system. It is department practice to reconcile daily the amounts received to those posted to its computer systems and to reconcile monthly the amounts posted to its computer systems to amounts recorded on the state's accounting system for each revenue account. These reconciliations, if appropriately completed, should ensure all amounts received are appropriately recorded on taxpayer records and on the state's accounting system.

Findings and Recommendations

We verified department personnel perform the daily and monthly reconciliations described above, but found during our review of five daily reconciliations from fiscal year 2005-06, that all of the daily reconciliations reviewed were incomplete or contained errors. As a result, not all differences were completely identified and resolved. This increases the risk that the information recorded is incorrect or that amounts received are not deposited, which, in turn, increases the risk of undetected loss or theft of department collections.

We found one of the daily reconciliations excluded \$2,151,216 of Automated Clearing House (ACH) activity posted to taxpayer accounts, so incorrectly calculated that deposits exceeded collections posted to taxpayer accounts by \$1,491,477 when support showed postings to taxpayer accounts exceeded collections by \$659,739. A \$1,478,344 reconciling item was listed, but was not supported. After we brought this issue to the department's attention, department personnel revised the daily reconciliation form and fully reconciled the five days we reviewed. Based on the completed reconciliations, we found three of the initial reconciliations had excluded ACH and online deposits, which created the appearance of differences ranging from \$15,560 to \$75,620 that did not exist. On a fourth reconciliation, the department had incorrectly used an amount from the previous day's report, resulting in a \$74,318 difference that did not exist. On a fifth reconciliation, department personnel had incorrectly included a batch as a deposit, resulting in \$14,936 more differences than the reconciliation disclosed.

Department personnel attributed the incomplete and erroneous daily reconciliations to turnover in personnel responsible for the reconciliations and differences in how the reports used to prepare the reconciliations summarize information. We also found that the instructions for completing the reconciliations were incomplete and information has to be gathered from numerous sources to complete the reconciliations. Ensuring the reports used for the daily reconciliations are accurate and summarize information on the same basis would reduce the number of differences that are identified and need to be resolved. Designing the reconciliation forms and

Findings and Recommendations

instructions to facilitate gathering information from all the relevant sources and comparing that information by related sources, as the department did after our review, will also help identify differences and document the resolution of those differences. Supervisory reviews could detect incomplete reconciliations, including differences that have not been resolved.

Recommendation #1

We recommend the department implement controls to ensure daily reconciliations of receipts to amounts recorded on its taxpayer systems are complete and accurate.

Unrecorded Revenue and Expenditures

The department did not properly record an estimated \$9,698,587 in business equipment tax rate reduction reimbursements to local governments or \$482,943 in collection activity under its contract with a collection agency during fiscal years 2004-05 and 2005-06.

Local Government Reimbursements

Section 15-1-112, MCA, provides for reimbursement to local governments for the revenue losses stemming from the Class 8 business equipment rate reduction. Since June 1996, this law has required county treasurers to reduce the county payment to the state for the 40-mill state equalization aid levy by a reimbursement amount calculated in accordance with a formula provided for in state law. The department recorded the amount counties remitted (net of the reimbursement) as 40-mill property tax revenue. The department should have recorded the entire amount collected by counties for the 40-mill state equalization aid levy as 40-mill property tax revenue and the reimbursement amount retained by the counties as local assistance expenditures, to comply with state law requiring financial activity be recorded in accordance with generally accepted accounting principles.

The department provides information to the counties regarding the reimbursement amounts to retain. Department personnel calculated the amount counties should have retained (i.e., the amount of

Findings and Recommendations

unrecorded General Fund local assistance expenditures and property tax revenue) related to the business equipment tax rate reduction reimbursement was \$5,615,920 for fiscal year 2004-05 and \$4,082,667 for fiscal year 2005-06. According to department calculations, county reimbursements, which are reduced each year by ten percent of the fiscal year 1998-99 amount, should have totaled \$73,168,953 from fiscal year 1998-99 through 2005-06. The department did not have the calculations for fiscal years 1995-96 to 1997-98 readily available. The reimbursements remaining prior to full phase-out in fiscal year 2007-08 should not exceed \$2,721,778 and \$1,360,889 in fiscal years 2006-07 and 2007-08, respectively.

Collection Agency Contract

As discussed in our prior audit, the department had contracted with a collection agency through September 2005 to assist in recovering past due individual income taxes. The collection agency retained its fee and forwarded the remainder of the taxes collected to the department. The department accounted for the transaction by recognizing cash received and net revenue. The department should have also recorded other services expenditures and tax revenue for the fee amount retained by the collection agency. The department acted with the legislature to cancel the contract with the collection agency early and did so at the end of fiscal year 2004-05. The amount of unrecorded General Fund other services expenditures and tax revenue related to contracted collection activity was \$482,943 for fiscal year 2004-05.

Recommendation #2

We recommend the department record revenues and expenditures for local government reimbursements and collection agency contracts, as required by state law.

Debt Collection Program

The department charged a disproportionate share of debt collection program costs to the General Fund in fiscal year 2005-06 (for collection of child support payment debts) and debt collection program fee revenues were not commensurate with

Findings and Recommendations

costs for fiscal years 2004-05 and 2005-06, resulting in excessive fund equity.

The department has one Internal Service Fund which is used to account for the department's debt collection program. In accordance with section 17-7-123(1)(f)(ii), MCA, the legislature approved a maximum delinquent account collection fee rate of ten percent of the amounts collected for fiscal years 2004-05 and 2005-06. Section 17-8-101(6), MCA, requires Internal Service Fund fees be commensurate with costs. Section 17-4-106(2), MCA, requires the delinquent account collection fees deposited in excess of the amount appropriated for operation of the debt collection program be carried forward into the next fiscal year and used to reduce the delinquent account collection fee rate.

Child Support Debt Collection Costs

Beginning in fiscal year 2005-06, the legislature prohibited the department from charging the delinquent account collection fee on collections related to child support payments and provided a General Fund appropriation of \$73,730 for child support debt collection costs. According to department personnel, collections related to child support debts would have generated \$79,313 in fee revenue in fiscal year 2005-06 had the fee not been prohibited, so child support debt collections represented 42.54 percent of the debt collection program's activity. Because department personnel understood the language of Chapter 607, Laws of 2005, to mean they could not charge the collection fee but could charge costs to the General Fund, they moved \$21,584 of Internal Service Fund costs, representing all of the Internal Service Fund's operating expenses at that date, to the General Fund. Department personnel said the General Fund appropriation was limited to operating expenses and they would have had to submit a Budget Change Document to allow personal services expenditures to be charged to the General Fund appropriation.

Department personnel also said they were concerned about complying with the requirements of section 17-2-108, MCA, which requires expenditures be applied against nongeneral fund money whenever possible before using general fund appropriations.

Findings and Recommendations

However, state law also requires the department to record the receipt, use and disposition of all money, for which it is accountable, in accordance with generally accepted accounting principles. Those principles require the Internal Service Fund be used to report any activity that provides goods or services to other funds, departments or agencies on a cost-reimbursement basis. Therefore, costs related to services for which the Internal Service Fund does not charge should not be recorded in the Internal Service Fund. Since the legislature prohibited the department from charging a fee for child support payment collections and provided a General Fund appropriation specifically for the cost of collecting child support debt, the requirements of section 17-2-108, MCA, did not apply to these costs.

The General Fund's proportionate share of costs was \$58,246, or \$36,662 more than was moved to the General Fund. By charging the General Fund disproportionately low costs, the department charged the Internal Service Fund disproportionately high costs, which unfairly impacts the rate charged to other agencies for debt collection services. Charging the General Fund for its proportionate share of costs would have increased working capital and fund balance in the Internal Service Fund at June 30, 2006, by \$36,662, nearly 25 percent above the level recorded.

Internal Service Fund Rate

The department last analyzed its Internal Service Fund in September 2004, prior to the changes made during the 2005 legislative session related to child support debt collections. At that time, the department estimated fee revenues would be \$145,000 for each fiscal year 2004-05 and 2005-06, although fee revenues for fiscal year 2003-04 were \$170,907 and the program manager expected the higher collections to continue. The department projected a ten percent collection fee would generate operating losses in fiscal years 2004-05, 2005-06, and 2006-07, leaving a projected fund balance of \$99,694. This fund balance was sufficient to fund costs for nearly eight months. The debt collection program collects the largest amount of revenues on delinquent accounts through offsets of individual income tax

Findings and Recommendations

refunds and permit application refunds made by the Department of Fish, Wildlife and Parks. The timing of these two major collections sources makes it necessary for the program to have a nine-month working capital balance at June 30 each year to fund expenses throughout the next year.

The department's Internal Service Fund fee revenues were \$184,240, which exceeded costs of \$156,922 by \$27,318 (17 percent) in fiscal year 2004-05. Due to the legislative change regarding child support debt collections, fee revenues were \$107,122, which is \$8,215 (7.1 percent) less than the department's recorded Internal Service Fund costs of \$115,337 in fiscal year 2005-06. Had costs been properly allocated to the General Fund, as discussed above, the department's Internal Service Fund fee revenues would have exceeded costs of \$78,675, by \$28,447, or 36 percent. At June 30, 2005, and 2006, the department had sufficient recorded working capital and fund balance in the Internal Service Fund to fund all costs of operation (including collection of child support debts) for 12 and 13 months, at the fiscal year 2004-05 and 2005-06 levels of activity, respectively.

Although the program experienced higher collections than projected in fiscal year 2004-05 and the legislature affected the funding of the program by prohibiting the collection fee on child support debt in fiscal year 2005-06, the department did no further analysis of the fund and took no action to reduce the rate. The department should analyze Internal Service Fund activity and balances and reduce fees to comply with state law.

Recommendation #3

We recommend the department:

- A. Charge the General Fund a proportionate share of debt collection program costs for collecting child support debt.**
- B. Adjust its delinquent account collection rate to be commensurate with costs, in accordance with state law.**
- C. Move \$36,662 of fiscal year 2005-06 costs from the Internal Service Fund to the General Fund.**

Findings and Recommendations

Improving Tax Compliance

The department is responsible for the administration and enforcement of many of the state's tax laws. We found the department could change procedures to improve taxpayer and department compliance with state tax laws related to combined oil and gas severance, corporation license, and individual income taxes.

Combined Oil and Gas Severance (COGS) Taxes

The department does not have adequate procedures to ensure COGS tax liabilities are reasonable for producers that are not the largest producers and to immediately estimate taxes for COGS nonfilers, as required by section 15-36-313(1), MCA.

Production and Sales Reporting Discrepancies

COGS collections were \$126.8 million and \$192.8 million in fiscal years 2004-05 and 2005-06, respectively. COGS producers are required to file and pay taxes, based on reported production and sales data, quarterly. The department's audit function provides a means for the department to examine taxpayers' financial records to determine whether they have accurately calculated and reported their tax liabilities. Only the largest producers, representing approximately 85 percent of total reported COGS tax revenue, receive audits that verify production and sales data.

The Board of Oil and Gas Conservation (BOGC) requires oil and gas producers to report production and sales data monthly. In the past, the department cross-matched data received with quarterly tax returns to the data provided to the BOGC and followed up large or unexpected differences through contact with the producer. Department personnel indicated they do not currently have the staff resources to perform these procedures. Comparing tax return information to the BOGC data may help the department identify unreported COGS tax liabilities.

We compared production and sales data that six producers reported to the department through quarterly tax returns to the production and sales data those producers reported to the BOGC for the same period. We found discrepancies for three of the six producers tested: three discrepancies for gas and two for oil, ranging from 7 to 48 percent of the amounts reported to the department on tax returns. In

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all but one case, the producer reported higher oil and gas production data to the department than to the BOGC.

We also compared the department's listing of taxpayers by lease unit for the fourth quarter of 2005 to the BOGC's listing of operators by lease unit for October through December 2005. We compiled a partial list of the operators and leases that were on one listing but not on the other listing and asked department personnel to research these differences. They found four of the operators on the BOGC's listing that were not on the department's listing had not filed tax returns. They also found a fifth operator had not filed taxes for two lease units reported to the BOGC that were not reported to the department. Based on these results, department personnel indicated in June 2006 that they have started to perform this cross-match again.

Assessing COGS for Nonfilers

When COGS taxpayers fail to file taxes within the time required, the department is required by section 15-36-313(1), MCA, to ascertain the amount of oil and gas produced and sold during the quarter and each month of the quarter, immediately after the time for filing has expired. The department is also required to determine the average value of the oil and gas produced and sold, and to fix the amount of taxes due for the quarter.

In June 2006, the department was identifying, contacting, and estimating taxes for nonfilers for the quarter ended September 30, 2005. Department personnel stated they do not have the staff resources to estimate tax liabilities immediately after the time has expired. The department should work with the BOGC to develop procedures to facilitate efficient comparison of oil and gas production and sales information by operator and lease.

Recommendation #4

We recommend the department work with the Board of Oil and Gas Conservation to develop and implement procedures for cross-matching oil and gas production and sales data to ensure all oil and gas severance taxes owed are reported or assessed in accordance with state law.

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Corporation License Taxes

The department does not have adequate procedures to ensure all new corporations, limited partnerships, limited liability companies, and limited liability partnerships file timely tax returns or the Secretary of State is notified, as required by section 15-31-523, MCA.

Section 15-31-603, MCA, requires the Secretary of State to provide a list of all new corporations, limited partnerships, limited liability companies, and limited liability partnerships, foreign and domestic, to the department each month. The department can use this list, required since October 2001, to identify and communicate tax reporting responsibilities to potentially new taxpayers and to identify entities that may not be paying their tax liabilities. The department is required by section 15-31-523, MCA, to report corporation license tax nonfilers or delinquent filers to the Secretary of State so the suspension, forfeiture, or dissolution of corporate rights provided in law can be made.

We observed the department's electronic comparison of the Secretary of State's information to IRIS data for the months of March and June 2006. Department personnel electronically compare the names and addresses of new foreign and domestic corporations from the information electronically provided by the Secretary of State, but exclude the other entities. The department could expand its ability to identify potentially new taxpayers by comparing all entities provided by the Secretary of State. For example, the March 2006 information originally provided by the Secretary of State contained 1,888 entities, of which 594 were new foreign and domestic corporations. Department personnel told us that when the corporation license tax was implemented into IRIS, the only functionality for the comparison that was programmed was what existed for the previous system, which was limited to new foreign and domestic corporations.

If the name and address on the Secretary of State's information nearly matches IRIS data, the electronic comparison requires department personnel to review the information from both sources to

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determine if there is a match or not. If there is any question whether the information matches, department personnel treat the entity as if it does not match an entity on IRIS. This process could work more efficiently if the Secretary of State gathered the taxpayer ID and provided it to the department with the other entity information.

The department does not notify the Secretary of State when a corporation does not file or is delinquent in filing, unless department personnel know the corporation is currently operating. Department personnel do not check with the Secretary of State or its website to see whether the corporation is active. Department personnel indicated that past history has shown most corporations that do not file returns have already voluntarily dissolved or are no longer active corporations. In addition, when returns come into central cashiering, they can get backed up and may not be entered into the system right away. The department should develop procedures to ensure the Secretary of State is notified of nonfilers and delinquent filers in a timely manner.

Recommendation #5

We recommend the department:

- A. Work with the Secretary of State to obtain the information necessary for an efficient comparison of new entity information.**
- B. Compare information to department records for all of the entities the Secretary of State reports.**
- C. Implement more effective procedures for identifying and reporting corporation license tax nonfilers and delinquent filers to the Secretary of State as required by state law.**

Individual Income Taxes

The department's individual income tax booklet for tax year 2005 was inconsistent with one state law and did not disclose requirements from four state laws that could either benefit taxpayers or facilitate taxpayer compliance.

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Income Limitation for Dependent Exemption

Each tax year, the department publishes an individual income tax booklet to help taxpayers prepare their Montana taxes. This tax booklet contains information on the criteria that must be met in order for the taxpayer to claim a \$1,900 exemption for a dependent. One of the criteria defining a dependent in the 2005 tax booklet is a person other than a child of the taxpayer "... who does not have gross income of more than \$1,900" Section 15-30-112(5)(a)(i), MCA, states "... an exemption of \$1,900 is allowed for each dependent: (i) whose gross income for the calendar year in which the tax year of the taxpayer begins is less than \$800; or (ii) who is a child of the taxpayer"

Section 15-30-112(6), MCA, requires the department, by November 1 of each year, to multiply all exemptions provided in this section of the law by the inflation factor for that tax year. The department has been applying the inflation factor to the income limitation of dependents other than taxpayers' children, as well as to the exemptions, since 1980 and believes that it is appropriate to adjust the income limitation for inflation. As a result, the department has been allowing exemptions for dependents that are not provided for in law. The amount of such exemptions is not known, because these exemptions are not reported and tracked separately from other dependent exemptions.

Requirements not in Individual Income Tax Booklet

The following laws that could either benefit the taxpayer or disclose compliance requirements to the taxpayers were not included in the 2005 tax booklet.

- 1) Section 15-30-105(2), MCA, discusses an alternative tax calculation option for non-residents.
- 2) Section 15-30-121(1)(i), MCA, discusses the deductions that are allowed for livestock fees that have been imposed on the taxpayer by other sections of state law.
- 3) Section 15-30-106, MCA, discusses imposition of a tax on the portion of a lump-sum distribution allowed as a deduction by section 62(a)(8) of the Internal Revenue Code.

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- 4) Section 15-30-142(3), MCA, discusses the preparation and signing of a return by someone other than the taxpayer when the taxpayer is unable to prepare their own return.

The department expanded the tax forms in the 2005 tax booklet from the forms in the 2004 booklet in order to reflect all features of Montana law. Department personnel indicated items (1) and (2) above would apply to a very small population; item (3) was a line item in the 2004 tax booklet, but was excluded from the 2005 booklet and taxpayers who called to ask where they should include this information were told to put it on the line for the rural physician credit; and item (4) could be clarified. By excluding the information contained in the laws discussed above from the tax booklet, the department increases the risk that taxpayers will not be aware of the related requirements or options and may prepare their return or calculate their tax liability incorrectly.

Recommendation #6

We recommend the department:

- A. Comply with section 15-30-112, MCA, concerning the income limitation of dependents other than taxpayers' children.**
- B. Improve the tax booklet by including all information affecting individual income tax computations contained in state law.**

Other State Compliance Issues

The department is not in compliance with certain state statutes and certain statutes affecting the department's operations are out of date.

Section 15-1-201, MCA, provides the department has general supervision over the administration of many of the assessment and tax laws of the state. During this audit, we tested the department's compliance with approximately 230 state laws and appropriation restrictions. In addition to the previously noted instances of noncompliance with state law, we found the department did not

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comply with other state statutes, some of which are out of date, as discussed below.

Property Tax Assessments for Cellular Phone Companies

Historically, cellular phone company property taxes have been locally assessed. Section 15-23-101, MCA, requires the department to centrally assess "... property owned by a corporation or other person operating in a single and continuous property operated in more than one county or more than one state, including but not limited to telegraph, telephone," When this law was written, the advent of the cellular phone was not specifically anticipated. However, the use of the term "telephone" in the statute can be logically construed to include cellular phone companies. In addition, cellular phone companies are generally operated in multiple counties and states as single entities so they should be assessed centrally as required by law.

The local assessments include land (with a taxable percentage of 3.14 percent in 2006 and 3.22 percent in 2005) and equipment (with a taxable percentage of 3.00 percent). If the cellular phone companies were centrally assessed, they would be valued in a different manner and assessed at a taxable percentage of 6 percent. Because the differences in valuation are not currently known, the difference in assessment amounts is unknown.

Additional Penalties for Purposely Failing to File or Pay Taxes When Due

The legislature established uniform penalty and interest assessments for taxpayer violations of filing and payment requirements for individual income, corporation, and combined oil and gas severance taxes in section 15-1-216, MCA. Sections (1)(b) and (1)(d) of this statute include additional penalties for persons that purposely fail to file a required return and purposely fail to pay a tax when due. The department's administrative rules do not address how to determine if a taxpayer purposely failed to file or pay taxes when due, and therefore whether the additional penalty laws should be applied. Because the department does not have standard procedures or rules in place for determining whether a taxpayer purposely failed to file or pay taxes when due, the Individual Income and Corporation Tax units do not assess the additional penalties required by section 15-1-216, MCA. The Natural Resource Tax unit assesses these

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additional penalties only when it is very clear the taxpayer purposely failed to file a tax return or pay a tax when due. As a result, these units do not comply with the requirements of the additional penalties law.

Statutory Housekeeping

The following statutes affecting the department's operations are out of date.

Municipal Corporations

As discussed in our prior audit report, section 15-1-201(3), MCA, requires the department to collect information on expenditure of public funds for all purposes from officers of municipal corporations to assist the department in its work. Department personnel noted they no longer collect this information because it is not needed. We determined the department is in substantial compliance with section 15-1-201, MCA, but should seek legislation to amend this statute to reflect the current information needs of the department.

Statement of Coal Sales

Section 15-35-104, MCA, requires each coal mine operator to provide a statement of the tons of coal sold to each purchaser for the quarter. The department has not required coal mine operators to provide this statement for several years, because the tax is no longer based on this information. Therefore the forms and instructions provided by the department for coal taxes do not contain this requirement. The department should seek legislation to amend this statute to reflect its current information needs.

Recommendation #7

We recommend the department:

- A. Centrally assess cellular phone companies as required by section 15-23-101, MCA.**
- B. Implement procedures and administrative rules to provide consistency in assessing additional penalties for purposely failing to file or pay taxes when due, as required by sections 15-1-216(1)(b) and (1)(d), MCA.**
- C. Seek legislation to amend sections 15-1-201 and 15-35-104, MCA, to reflect the department's current information needs from municipal corporations and coal mine operators.**

Audit Collections

House Joint Resolution No. 2 of the 2001 Legislature requires the department to “provide the Legislative Fiscal Division with reports at least quarterly concerning aggregate audit collections for the individual income tax, corporation license tax, coal severance tax, telecommunications tax, and oil and natural gas production tax, beginning with the quarter ending September 2001. The reports must include for each tax type the amount of tax, penalty, and interest.” The resolution indicated the purpose of this requirement was to obtain the assistance of the Executive Branch in the Legislature’s development of revenue estimates. The Legislature also indicated that it recognized the importance of integrating the department’s Process Oriented Integrated System (POINTS) computer system with the state accounting system to enable the separate reporting of audits, penalties, and interest collections on the accounting system.

The department created a formal procedure to ensure this mandate was followed. Section 2.1 of this procedure defined audit collections as the:

“... net revenue generated for each tax type, which is the result of various compliance activities. This includes:

- 2.1a refund reductions;
- 2.1b error sheet corrections for individual income tax;
- 2.1c prepaid interest and penalty;
- 2.1d prior-year and amended returns, ...;
- 2.1e federal RAR’s (revenue agent reports);
- 2.1f accruals of compliance activity revenue;
- 2.1g standard audit payments with interest and penalty related to these payments; and
- 2.1h other compliance activities that may be undertaken by the department.”

Disclosure Issue

Chapter 607, Laws of 2005, provided a \$1,120,000 restricted biennial General Fund appropriation for additional tax compliance staff. Chapter 612, Laws of 2003 required the department to present reports to the Revenue and Transportation Interim Committee that show the cost of tax compliance staff and the additional revenue generated from providing the associated tax compliance, indicating legislative interest in measuring the effectiveness of the department's audit collection activities.

In the past, the department has counted collections from a reminder letter sent to those who file their individual income tax return early and opt to pay the tax on or before the due date as audit collections. The department adjusted the reminder letter collections out of its audit collection amounts for individual income taxes in June 2006. Prepaid interest and penalty is self-assessed by the taxpayer when the taxpayer files their tax return and is not necessarily a result of department personnel's tax compliance activities. Including prepaid interest and penalty in the department's calculation of audit collections overstates the results of its compliance activities, but the department continues to include this amount as an audit collection.

The department's revised audit collection amounts for individual income taxes, which exclude reminder letters and include prepaid penalty and interest, are as follows.

| Fiscal Year | Revised Audit Collections (Includes Prepaid Penalty & Interest) |
|----------------|--|
| 2001-02 | \$14,475,006 (\$1,248,463) |
| 2002-03 | \$17,933,623 (\$1,198,506) |
| 2003-04 | \$21,397,674 (\$1,300,916) |
| 2004-05 | \$25,809,434 (\$1,474,398) |
| 2005-06 | \$22,480,912 (\$ 537,338) |

On June 29, 2006, the department reported audit collections for corporation license taxes and combined oil and gas taxes to the Revenue and Transportation Interim Committee, as follows:

| Fiscal Year | Corporation License Taxes | Combined Oil & Gas Taxes |
|----------------|------------------------------|-----------------------------|
| 2003-04 | \$14,173,762 | \$1,689,338 |
| 2004-05 | \$10,596,540 | \$1,127,243 |
| 2005-06* | \$10,499,506 | \$1,637,574 |

*For the partial fiscal year through June 26, 2006

The department also includes in its calculation of audit collections, amounts collected as a result of system edits rather than as a result of effort initiated by audit. Examples of such edits include edits to ensure the return is mathematically accurate, the exemption amount claimed equals the allowable amount per exemption times the number of exemptions claimed on an earlier line of the return, or the tax is properly calculated based on taxable income and the tax tables. While system edits are a compliance tool that, once an error is identified, may require audit follow-up, it would not necessarily be appropriate to include these amounts in an estimate of the increased collections additional audit positions could generate. The department's audit collections amount may be misleading if it is used to determine the cost benefit of existing or additional audit staff.

Because the department is following its formally adopted definition of audit collections, this issue is presented for disclosure purposes only and we make no recommendation at this time.

Independent Auditor's Report & Agency Financial Schedules

LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor
Tori Hunthausen,
Chief Deputy Legislative Auditor



Deputy Legislative Auditors:
James Gillett
Jim Pellegrini

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the accompanying Schedules of Changes in Fund Balances & Property Held in Trust, Schedules of Total Revenues & Transfers-In, and Schedules of Total Expenditures & Transfers-Out of the Department of Revenue for each of the fiscal years ended June 30, 2006, and June 30, 2005. The information contained in these financial schedules is the responsibility of the department's management. Our responsibility is to express an opinion on these financial schedules based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial schedules are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial schedules. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial schedule presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in note 1, the financial schedules are presented on a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America. The schedules are not intended to be a complete presentation and disclosure of the department's assets, liabilities, and cash flows.

The department recorded its June 2006 liquor purchases when paid in fiscal year 2006-07 instead of when incurred in fiscal year 2005-06. As a result, in the Enterprise Fund, Goods Purchased for Resale (Budgeted) Expenditures for the Liquor Control Division in fiscal year 2005-06 were understated, Unspent Budget Authority for the Liquor Control Division for fiscal year 2005-06 was overstated, and Fund Balance at June 30, 2006, was overstated by \$4,552,876.

In our opinion, except for the effects of the matter discussed in the preceding paragraph, the financial schedules referred to above present fairly, in all material respects, the results of operations and changes in fund balances and property held in trust of the Department of Revenue for each of the fiscal years ended June 30, 2006, and June 30, 2005, in conformity with the basis of accounting described in note 1.

Respectfully submitted,
/s/ James Gillett

James Gillett, CPA
Deputy Legislative Auditor

August 31, 2006

DEPARTMENT OF REVENUE
SCHEDULE OF CHANGES IN FUND BALANCES & PROPERTY HELD IN TRUST
FOR THE FISCAL YEAR ENDED JUNE 30, 2006

| | General Fund | State Special Revenue Fund | Federal Special Revenue Fund | Debt Service Fund | Capital Projects Fund | Enterprise Fund | Internal Service Fund | Agency Fund | Private Purpose Trust Fund | Permanent Fund |
|---|-----------------|-------------------------------|---------------------------------|----------------------|--------------------------|--------------------|--------------------------|----------------|-------------------------------|-------------------|
| FUND BALANCE: July 1, 2005 | \$ 8,743,037 | \$ 33,175,011 | \$ (1,999) | \$ 101,398 | \$ 1,325,387 | \$ 2,360,446 | \$ 156,627 | \$ 693,990 | \$ 707,340 | \$ 851,504,459 |
| PROPERTY HELD IN TRUST: July 1, 2005 | | | | | | | | \$ (565,361) | | |
| ADDITIONS | | | | | | | | | | |
| Budgeted Revenues & Transfers-In | 1,318,609,805 | 260,585,311 | 318,659 | | 6,291,706 | 75,866,582 | 107,123 | | | 51,483,754 |
| Nonbudgeted Revenues & Transfers-In | 956,884 | 5,983,964 | | 528,391 | | 12,651,855 | | 21,149 | 1,533,318 | 23,542,712 |
| Prior Year Revenues & Transfers-In Adjustments | 68,860,706 | 2,916,216 | | (18,559) | (237,827) | (12,217,945) | | (21,149) | | (804,297) |
| Direct Entries to Fund Balance | (1,256,459,527) | (162,434,251) | | (526,154) | (6,284,030) | (802,234) | | (693,990) | | (712,866) |
| Additions to Property Held in Trust | | | | | | | | 4,692,481 | | |
| Total Additions | 131,967,868 | 107,051,240 | 318,659 | (16,322) | (230,151) | 75,498,258 | 107,123 | 3,998,491 | 1,533,318 | 73,509,303 |
| REDUCTIONS | | | | | | | | | | |
| Budgeted Expenditures & Transfers-Out | 125,059,809 | 107,276,135 | 316,370 | | | 69,100,296 | 113,841 | | | |
| Nonbudgeted Expenditures & Transfers-Out | (2,669) | 1,281,833 | | | | 865,715 | 1,230 | | 1,387,733 | 85,690,973 |
| Prior Year Expenditures & Transfers-Out Adjustments | 49,988 | 1,685,378 | 322 | | | (82) | 275 | | | |
| Reductions in Property Held in Trust | | | | | | | | 3,874,260 | | |
| Total Reductions | 125,107,128 | 110,243,346 | 316,692 | | | 69,965,929 | 115,346 | 3,874,260 | 1,387,733 | 85,690,973 |
| FUND BALANCE: June 30, 2006 | \$ 15,603,777 | \$ 29,982,905 | \$ (32) | \$ 85,076 | \$ 1,095,236 | \$ 7,892,775 | \$ 148,404 | \$ 0 | \$ 852,925 | \$ 839,322,789 |
| PROPERTY HELD IN TRUST: June 30, 2006 | | | | | | | | \$ 252,860 | | |

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment.
Additional information is provided in the notes to the financial schedules beginning on page A-11.

DEPARTMENT OF REVENUE
SCHEDULE OF CHANGES IN FUND BALANCES & PROPERTY HELD IN TRUST
FOR THE FISCAL YEAR ENDED JUNE 30, 2005

| | General Fund | State Special Revenue Fund | Federal Special Revenue Fund | Debt Service Fund | Capital Projects Fund | Enterprise Fund | Internal Service Fund | Agency Fund | Private Purpose Trust Fund | Permanent Fund |
|---|-----------------|-------------------------------|---------------------------------|----------------------|--------------------------|-----------------|--------------------------|--------------|-------------------------------|----------------|
| FUND BALANCE: July 1, 2004 | \$ 8,543,817 | \$ 10,088,740 | \$ 2,060,153 | \$ 66,830 | \$ 1,045,346 | \$ 6,928,271 | \$ 129,321 | \$ 693,990 | \$ 363,841 | \$ 825,282,889 |
| PROPERTY HELD IN TRUST: July 1, 2004 | | | | | | | | \$ 945,912 | | |
| ADDITIONS | | | | | | | | | | |
| Budgeted Revenues & Transfers-In | 1,158,855,298 | 187,464,327 | 267,390 | | 6,352,088 | 68,314,943 | 184,240 | | | 90,170,980 |
| Nonbudgeted Revenues & Transfers-In | 1,335,987 | 18,242,478 | | 357,528 | | 11,746,839 | | 16,440 | 1,940,533 | 7,722,021 |
| Prior Year Revenues & Transfers-In Adjustments | 71,315,199 | 1,779,363 | | 25,703 | 316,971 | (12,343,332) | | (16,440) | 19,344 | 642,364 |
| Direct Entries to Fund Balance | (1,096,214,818) | (105,383,809) | (2,060,177) | (348,663) | (6,230,728) | (4,727,132) | | | 202,034 | (707,607) |
| Additions to Property Held in Trust | | | | | | | | 9,033,422 | | |
| Total Additions | 135,291,666 | 102,102,359 | (1,792,787) | 34,568 | 438,331 | 62,991,318 | 184,240 | 9,033,422 | 2,161,911 | 97,827,758 |
| REDUCTIONS | | | | | | | | | | |
| Budgeted Expenditures & Transfers-Out | 134,542,779 | 69,212,627 | 269,365 | | 158,290 | 66,805,754 | 157,438 | | | |
| Nonbudgeted Expenditures & Transfers-Out | 375,000 | 9,389,357 | | | | 750,755 | (504) | | 1,818,412 | 70,723,998 |
| Prior Year Expenditures & Transfers-Out Adjustments | 174,667 | 414,104 | | | | 2,634 | | | | 882,190 |
| Reductions in Property Held in Trust | | | | | | | | 10,544,695 | | |
| Total Reductions | 135,092,446 | 79,016,088 | 269,365 | | 158,290 | 67,559,143 | 156,934 | 10,544,695 | 1,818,412 | 71,606,188 |
| FUND BALANCE: June 30, 2005 | \$ 8,743,037 | \$ 33,175,011 | \$ (1,999) | \$ 101,398 | \$ 1,325,387 | \$ 2,360,446 | \$ 156,627 | \$ 693,990 | \$ 707,340 | \$ 851,504,459 |
| PROPERTY HELD IN TRUST: June 30, 2005 | | | | | | | | \$ (565,361) | | |

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment.
Additional information is provided in the notes to the financial schedules beginning on page A-11.

DEPARTMENT OF REVENUE
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN
FOR THE FISCAL YEAR ENDED JUNE 30, 2006

| | General Fund | State Special Revenue Fund | Federal Special Revenue Fund | Debt Service Fund | Capital Projects Fund | Enterprise Fund | Internal Service Fund | Agency Fund | Private Purpose Trust Fund | Permanent Fund | Total |
|--|-----------------|-------------------------------|---------------------------------|----------------------|--------------------------|--------------------|--------------------------|----------------|-------------------------------|-------------------|---------------|
| TOTAL REVENUES & TRANSFERS-IN BY CLASS | | | | | | | | | | | |
| Licenses and Permits | \$ 5,901,042 | \$ 20,072,783 | | | | \$ 1,948,078 | | | | | \$ 27,921,903 |
| Taxes | 1,299,377,583 | 209,596,533 | | \$ 509,832 | \$ 6,053,879 | 17,299,777 | | | | \$ 17,577,456 | 1,550,415,060 |
| Charges for Services | 244,771 | 7,997,665 | \$ 92,400 | | | 5,445 | \$ 107,123 | | | | 8,447,404 |
| Investment Earnings | (1,922) | | | | | | | | \$ 22,759 | 14,375,740 | 14,396,577 |
| Fines, Forfeits and Settlements | | | | | | 153,317 | | | | | 153,317 |
| Sale of Documents, Merchandise and Property | | | | | | 56,874,825 | | | | | 56,874,825 |
| Miscellaneous | (76,544) | | | | | 19,050 | | | | | (57,494) |
| Grants, Contracts, Donations and Abandonments | 2,785,316 | 246,675 | | | | | | | 1,510,559 | | 4,542,550 |
| Other Financing Sources | 52,741,016 | 20,484,053 | | | | | | | | 42,268,973 | 115,494,042 |
| Federal | 27,438,804 | 11,087,782 | 226,259 | | | | | | | | 38,752,845 |
| Federal Indirect Cost Recoveries | 17,329 | | | | | | | | | | 17,329 |
| Total Revenues & Transfers-In | 1,388,427,395 | 269,485,491 | 318,659 | 509,832 | 6,053,879 | 76,300,492 | 107,123 | \$ 0 | 1,533,318 | 74,222,169 | 1,816,958,358 |
| Less: Nonbudgeted Revenues & Transfers-In | 956,884 | 5,983,964 | | 528,391 | | 12,651,855 | | 21,149 | 1,533,318 | 23,542,712 | 45,218,273 |
| Prior Year Revenues & Transfers-In Adjustments | 68,860,706 | 2,916,216 | | (18,559) | (237,827) | (12,217,945) | | (21,149) | | (804,297) | 58,477,145 |
| Actual Budgeted Revenues & Transfers-In | 1,318,609,805 | 260,585,311 | 318,659 | 0 | 6,291,706 | 75,866,582 | 107,123 | 0 | 0 | 51,483,754 | 1,713,262,940 |
| Estimated Revenues & Transfers-In | 1,247,635,724 | 259,987,830 | 409,609 | | 5,698,548 | 83,488,324 | 145,000 | | | 90,540,004 | 1,687,905,039 |
| Budgeted Revenues & Transfers-In Over (Under) Estimated | \$ 70,974,081 | \$ 597,481 | \$ (90,950) | \$ 0 | \$ 593,158 | \$ (7,621,742) | \$ (37,877) | \$ 0 | \$ 0 | \$ (39,056,250) | \$ 25,357,901 |
| BUDGETED REVENUES & TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS | | | | | | | | | | | |
| Licenses and Permits | \$ 94,236 | \$ 3,511,850 | | | | \$ 243,113 | | | | | \$ 3,849,199 |
| Taxes | 78,758,197 | (2,849,887) | | | \$ 593,158 | 742,093 | | | | \$ 3,591,369 | 80,834,930 |
| Charges for Services | 25,066 | 1,137,095 | | | | 1,051 | \$ (37,877) | | | | 1,125,335 |
| Investment Earnings | (1,923) | (1,000,085) | | | | | | | | (42,493,470) | (43,495,478) |
| Fines, Forfeits and Settlements | | | | | | 25,538 | | | | | 25,538 |
| Sale of Documents, Merchandise and Property | | | | | | (8,629,753) | | | | | (8,629,753) |
| Miscellaneous | | | | | | (3,784) | | | | | (3,784) |
| Grants, Contracts, Donations and Abandonments | (685,000) | (153,018) | | | | | | | | | (838,018) |
| Other Financing Sources | (9,808,097) | (912,341) | | | | | | | | (154,149) | (10,874,587) |
| Federal | 2,591,602 | 863,867 | \$ (90,950) | | | | | | | | 3,364,519 |
| Budgeted Revenues & Transfers-In Over (Under) Estimated | \$ 70,974,081 | \$ 597,481 | \$ (90,950) | \$ 0 | \$ 593,158 | \$ (7,621,742) | \$ (37,877) | \$ 0 | \$ 0 | \$ (39,056,250) | \$ 25,357,901 |

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment.
Additional information is provided in the notes to the financial schedules beginning on page A-11.

DEPARTMENT OF REVENUE
SCHEDULE OF TOTAL REVENUES & TRANSFERS-IN
FOR THE FISCAL YEAR ENDED JUNE 30, 2005

| | General Fund | State Special Revenue Fund | Federal Special Revenue Fund | Debt Service Fund | Capital Projects Fund | Enterprise Fund | Internal Service Fund | Agency Fund | Private Purpose Trust Fund | Permanent Fund | Total |
|--|----------------|-------------------------------|---------------------------------|----------------------|--------------------------|-----------------|--------------------------|----------------|-------------------------------|----------------|----------------|
| TOTAL REVENUES & TRANSFERS-IN BY CLASS | | | | | | | | | | | |
| Licenses and Permits | \$ 6,487,765 | \$ 14,441,559 | | | | \$ 1,645,731 | | | | | \$ 22,575,055 |
| Taxes | 1,136,813,190 | 143,178,707 | | \$ 383,231 | \$ 6,669,059 | 15,616,305 | | | | \$ 21,188,985 | 1,323,849,477 |
| Charges for Services | 219,907 | 6,976,073 | \$ 92,400 | | | 4,465 | \$ 184,240 | | | | 7,477,085 |
| Investment Earnings | (22,279) | | | | | | | | \$ 8,474 | 56,697,260 | 56,683,455 |
| Fines, Forfeits and Settlements | | | | | | 133,409 | | | | | 133,409 |
| Sale of Documents, Merchandise and Property | | | | | | 50,304,982 | | | | | 50,304,982 |
| Miscellaneous | 22,310 | | | | | 13,558 | | | | | 35,868 |
| Grants, Contracts, Donations and Abandonments | 2,571,885 | 250,780 | | | | | | | 1,951,403 | | 4,774,068 |
| Other Financing Sources | 56,820,035 | 33,541,141 | | | | | | | | 20,649,120 | 111,010,296 |
| Federal | 28,580,215 | 9,097,908 | 174,990 | | | | | | | | 37,853,113 |
| Federal Indirect Cost Recoveries | 13,456 | | | | | | | | | | 13,456 |
| Total Revenues & Transfers-In | 1,231,506,484 | 207,486,168 | 267,390 | 383,231 | 6,669,059 | 67,718,450 | 184,240 | \$ 0 | 1,959,877 | 98,535,365 | 1,614,710,264 |
| Less: Nonbudgeted Revenues & Transfers-In | 1,335,987 | 18,242,478 | | 357,528 | | 11,746,839 | | 16,440 | 1,940,533 | 7,722,021 | 41,361,826 |
| Prior Year Revenues & Transfers-In Adjustments | 71,315,199 | 1,779,363 | | 25,703 | 316,971 | (12,343,332) | | (16,440) | 19,344 | 642,364 | 61,739,172 |
| Actual Budgeted Revenues & Transfers-In | 1,158,855,298 | 187,464,327 | 267,390 | 0 | 6,352,088 | 68,314,943 | 184,240 | 0 | 0 | 90,170,980 | 1,511,609,266 |
| Estimated Revenues & Transfers-In | 1,046,223,918 | 108,901,974 | 676,970 | 272,432 | 5,111,737 | 65,401,871 | 145,000 | | | 85,745,457 | 1,312,479,359 |
| Budgeted Revenues & Transfers-In Over (Under) Estimated | \$ 112,631,380 | \$ 78,562,353 | \$ (409,580) | \$ (272,432) | \$ 1,240,351 | \$ 2,913,072 | \$ 39,240 | \$ 0 | \$ 0 | \$ 4,425,523 | \$ 199,129,907 |
| BUDGETED REVENUES & TRANSFERS-IN OVER (UNDER) ESTIMATED BY CLASS | | | | | | | | | | | |
| Licenses and Permits | \$ 631,045 | \$ 2,680,256 | | | | \$ (484,739) | | | | | \$ 2,826,562 |
| Taxes | 114,643,731 | 72,306,541 | | \$ (272,432) | \$ 1,240,351 | 1,364,351 | | | | \$ 19,532,309 | 208,814,851 |
| Charges for Services | (5,254,925) | 814,913 | \$ 639 | | | (1,535) | \$ 39,240 | | | | (4,401,668) |
| Investment Earnings | (22,280) | (1) | | | | | | | | (28,311,824) | (28,334,105) |
| Fines, Forfeits and Settlements | (100) | | (268,000) | | | 42,281 | | | | | (225,819) |
| Sale of Documents, Merchandise and Property | | | | | | 1,992,714 | | | | | 1,992,714 |
| Miscellaneous | (1,314,904) | | | | | | | | | | (1,314,904) |
| Grants, Contracts, Donations and Abandonments | 946,300 | 14,168 | | | | | | | | | 960,468 |
| Other Financing Sources | (7,050,107) | (606,432) | | | | | | | | 13,205,038 | 5,548,499 |
| Federal | 10,058,725 | 3,352,908 | (142,219) | | | | | | | | 13,269,414 |
| Federal Indirect Cost Recoveries | (6,105) | | | | | | | | | | (6,105) |
| Budgeted Revenues & Transfers-In Over (Under) Estimated | \$ 112,631,380 | \$ 78,562,353 | \$ (409,580) | \$ (272,432) | \$ 1,240,351 | \$ 2,913,072 | \$ 39,240 | \$ 0 | \$ 0 | \$ 4,425,523 | \$ 199,129,907 |

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment.
Additional information is provided in the notes to the financial schedules beginning on page A-11.

DEPARTMENT OF REVENUE
SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT
FOR THE FISCAL YEAR ENDED JUNE 30, 2006

| PROGRAM (ORG) EXPENDITURES & TRANSFERS-OUT | Business & Income Taxes Division | Customer Service Center | Director's Office | Information Technology | Liquor Control Division | Property Assessment Division | Resource Management | Total |
|---|-------------------------------------|----------------------------|----------------------|---------------------------|----------------------------|---------------------------------|------------------------|-----------------------|
| Personal Services | | | | | | | | |
| Salaries | \$ 4,091,578 | | \$ 1,635,022 | \$ 2,967,824 | \$ 785,027 | \$ 8,254,171 | \$ 820,809 | \$ 18,554,431 |
| Hourly Wages | 659 | | | | | | | 659 |
| Other Compensation | 9,258 | | | 23,145 | | 8,328 | 13,887 | 54,618 |
| Employee Benefits | 1,350,649 | \$ 8,918 | 503,714 | 978,300 | 273,060 | 2,964,795 | 253,992 | 6,333,428 |
| Personal Services-Other | | 1,241 | | | 101,648 | | (72,795) | 30,094 |
| Total | <u>5,452,144</u> | <u>10,159</u> | <u>2,138,736</u> | <u>3,969,269</u> | <u>1,159,735</u> | <u>11,227,294</u> | <u>1,015,893</u> | <u>24,973,230</u> |
| Operating Expenses | | | | | | | | |
| Other Services | 283,521 | (22) | 3,219,586 | 1,778,057 | 102,629 | 2,034,136 | 499,994 | 7,917,901 |
| Supplies & Materials | 168,905 | | 104,521 | 476,997 | 78,179 | 415,812 | 28,004 | 1,272,418 |
| Communications | 129,298 | | 48,695 | 615,353 | 39,772 | 275,757 | 35,326 | 1,144,201 |
| Travel | 216,994 | | 60,853 | 17,752 | 2,400 | 259,309 | 2,537 | 559,845 |
| Rent | 163,453 | | 166,906 | 142,780 | 12,197 | 1,471,886 | 22,810 | 1,980,032 |
| Utilities | 1,966 | | | 487 | 82,740 | 1,333 | 606 | 87,132 |
| Repair & Maintenance | 73,062 | (4,260) | 27,826 | 637,313 | 85,612 | 66,405 | 5,131 | 891,089 |
| Other Expenses | 213,570 | 1,059 | 32,048 | 50,510 | 101,420 | 59,212 | 30,320 | 488,139 |
| Goods Purchased For Resale | | | | | 42,758,610 | | (1,718) | 42,756,892 |
| Total | <u>1,250,769</u> | <u>(3,223)</u> | <u>3,660,435</u> | <u>3,719,249</u> | <u>43,263,559</u> | <u>4,583,850</u> | <u>623,010</u> | <u>57,097,649</u> |
| Equipment & Intangible Assets | | | | | | | | |
| Equipment | | | 22,706 | 37,702 | 35,614 | 8,722 | | 104,744 |
| Intangible Assets | | | | | | | 80,716 | 80,716 |
| Total | | | <u>22,706</u> | <u>37,702</u> | <u>35,614</u> | <u>8,722</u> | <u>80,716</u> | <u>185,460</u> |
| Local Assistance | | | | | | | | |
| From State Sources | <u>3,288,951</u> | | <u>85,504,866</u> | | | <u>107,850,767</u> | <u>332,373</u> | <u>196,976,957</u> |
| Total | <u>3,288,951</u> | | <u>85,504,866</u> | | | <u>107,850,767</u> | <u>332,373</u> | <u>196,976,957</u> |
| From Other Sources | | | | | | | | |
| Distrib from Priv Purp Trusts | | 398,232 | | | | | 913,401 | 1,311,633 |
| Total | | <u>398,232</u> | | | | | <u>913,401</u> | <u>1,311,633</u> |
| Transfers | | | | | | | | |
| Accounting Entity Transfers | | | | | 25,067,679 | 87,213,422 | 220 | 112,281,321 |
| Total | | | | | <u>25,067,679</u> | <u>87,213,422</u> | <u>220</u> | <u>112,281,321</u> |
| Debt Service | | | | | | | | |
| Installment Purchases | | | | | | 897 | | 897 |
| Total | | | | | | <u>897</u> | | <u>897</u> |
| Total Expenditures & Transfers-Out | \$ <u>9,991,864</u> | \$ <u>405,168</u> | \$ <u>91,326,743</u> | \$ <u>7,726,220</u> | \$ <u>69,526,587</u> | \$ <u>210,884,952</u> | \$ <u>2,965,613</u> | \$ <u>392,827,147</u> |
| EXPENDITURES & TRANSFERS-OUT BY FUND | | | | | | | | |
| General Fund | \$ 5,921,043 | \$ 5,427 | \$ 91,297,675 | \$ 7,023,553 | | \$ 19,393,125 | \$ 1,466,305 | \$ 125,107,128 |
| State Special Revenue Fund | 3,733,500 | (8) | | 349,489 | | 105,724,755 | 435,610 | 110,243,346 |
| Federal Special Revenue Fund | 223,492 | | 800 | 92,400 | | | | 316,692 |
| Enterprise Fund | | | 28,268 | 260,778 | \$ 69,526,587 | | 150,296 | 69,965,929 |
| Internal Service Fund | 113,829 | 1,517 | | | | | | 115,346 |
| Private Purpose Trust Fund | | 398,232 | | | | 76,099 | 913,402 | 1,387,733 |
| Permanent Fund | | | | | | 85,690,973 | | 85,690,973 |
| Total Expenditures & Transfers-Out | <u>9,991,864</u> | <u>405,168</u> | <u>91,326,743</u> | <u>7,726,220</u> | <u>69,526,587</u> | <u>210,884,952</u> | <u>2,965,613</u> | <u>392,827,147</u> |
| Less: Nonbudgeted Expenditures & Transfers-Out | (531) | 399,473 | (303) | (458) | 913,311 | 87,047,567 | 865,756 | 89,224,815 |
| Prior Year Expenditures & Transfers-Out Adjustments | <u>8,999</u> | <u>5,695</u> | <u>1,857</u> | <u>3,475</u> | | <u>1,714,201</u> | <u>1,654</u> | <u>1,735,881</u> |
| Actual Budgeted Expenditures & Transfers-Out | 9,983,396 | 0 | 91,325,189 | 7,723,203 | 68,613,276 | 122,123,184 | 2,098,203 | 301,866,451 |
| Budget Authority | <u>11,879,534</u> | | <u>93,194,058</u> | <u>8,149,521</u> | <u>80,468,582</u> | <u>150,076,299</u> | <u>2,140,559</u> | <u>345,908,553</u> |
| Unspent Budget Authority | \$ <u>1,896,138</u> | \$ <u>0</u> | \$ <u>1,868,869</u> | \$ <u>426,318</u> | \$ <u>11,855,306</u> | \$ <u>27,953,115</u> | \$ <u>42,356</u> | \$ <u>44,042,102</u> |
| UNSPENT BUDGET AUTHORITY BY FUND | | | | | | | | |
| General Fund | \$ 777,871 | | \$ 1,868,869 | \$ 685 | | \$ 2,024,033 | \$ 50 | \$ 4,671,508 |
| State Special Revenue Fund | 1,020,664 | | | 425,633 | | 25,929,082 | 40,557 | 27,415,936 |
| Federal Special Revenue Fund | 48,047 | | | | | | | 48,047 |
| Enterprise Fund | | | | | \$ 11,855,306 | | 1,749 | 11,857,055 |
| Internal Service Fund | 49,556 | | | | | | | 49,556 |
| Unspent Budget Authority | \$ <u>1,896,138</u> | \$ <u>0</u> | \$ <u>1,868,869</u> | \$ <u>426,318</u> | \$ <u>11,855,306</u> | \$ <u>27,953,115</u> | \$ <u>42,356</u> | \$ <u>44,042,102</u> |

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

DEPARTMENT OF REVENUE
SCHEDULE OF TOTAL EXPENDITURES & TRANSFERS-OUT
FOR THE FISCAL YEAR ENDED JUNE 30, 2005

| PROGRAM (ORG) EXPENDITURES & TRANSFERS-OUT | Business & Income Taxes Division | Customer Service Center | Director's Office | Information Technology | Property Assessment Division | Resource Management | Total |
|---|-------------------------------------|----------------------------|-----------------------|---------------------------|---------------------------------|------------------------|-----------------------|
| Personal Services | | | | | | | |
| Salaries | \$ 3,032,600 | \$ 2,884,428 | \$ 1,354,902 | \$ 1,119,894 | \$ 8,224,452 | \$ 1,196,072 | \$ 17,812,348 |
| Other Compensation | | | | | 642 | 19,000 | 19,642 |
| Employee Benefits | 982,946 | 1,010,396 | 371,029 | 317,446 | 2,902,595 | 390,037 | 5,974,449 |
| Personal Services-Other | | (503) | | | | 4,643 | 4,140 |
| Total | <u>4,015,546</u> | <u>3,894,321</u> | <u>1,725,931</u> | <u>1,437,340</u> | <u>11,127,689</u> | <u>1,609,752</u> | <u>23,810,579</u> |
| Operating Expenses | | | | | | | |
| Other Services | 248,065 | 1,255,953 | 841,862 | 1,106,385 | 1,501,914 | 310,707 | 5,264,886 |
| Supplies & Materials | 90,028 | 106,417 | 151,021 | 322,983 | 448,316 | 50,816 | 1,169,581 |
| Communications | 71,590 | 632,297 | 35,883 | 20,912 | 265,160 | 39,894 | 1,065,736 |
| Travel | 120,674 | 42,833 | 46,038 | 17,293 | 253,199 | 2,671 | 482,708 |
| Rent | 48,906 | 116,926 | 140,046 | 130,224 | 1,320,796 | 17,550 | 1,774,448 |
| Utilities | 1,810 | 1,585 | | | 1,329 | 70,055 | 74,779 |
| Repair & Maintenance | 8,250 | 95,174 | 8,961 | 13,699 | 90,935 | 15,045 | 232,064 |
| Other Expenses | 156,872 | 25,321 | 28,828 | 30,343 | 36,912 | 173,709 | 451,985 |
| Goods Purchased For Resale | | | | | | 42,688,264 | 42,688,264 |
| Total | <u>746,195</u> | <u>2,276,506</u> | <u>1,252,639</u> | <u>1,641,839</u> | <u>3,918,561</u> | <u>43,368,711</u> | <u>53,204,451</u> |
| Equipment & Intangible Assets | | | | | | | |
| Equipment | | 22,000 | 5,746 | | | | 27,746 |
| Total | | <u>22,000</u> | <u>5,746</u> | | | | <u>27,746</u> |
| Local Assistance | | | | | | | |
| From State Sources | | | 85,132,086 | | 73,307,002 | 303,778 | 158,742,866 |
| Total | | | <u>85,132,086</u> | | <u>73,307,002</u> | <u>303,778</u> | <u>158,742,866</u> |
| From Other Sources | | | | | | | |
| Distrib from Priv Purp Trusts | | 1,781,680 | | | | | 1,781,680 |
| Total | | <u>1,781,680</u> | | | | | <u>1,781,680</u> |
| Transfers | | | | | | | |
| Accounting Entity Transfers | | | 22,204,009 | | 72,901,235 | 22,699,888 | 117,805,132 |
| Total | | | <u>22,204,009</u> | | <u>72,901,235</u> | <u>22,699,888</u> | <u>117,805,132</u> |
| Debt Service | | | | | | | |
| Loans | | | 303,440 | | | | 303,440 |
| Installment Purchases | | | | | 972 | | 972 |
| Total | | | <u>303,440</u> | | <u>972</u> | | <u>304,412</u> |
| Total Expenditures & Transfers-Out | \$ <u>4,761,741</u> | \$ <u>7,974,507</u> | \$ <u>110,623,851</u> | \$ <u>3,079,179</u> | \$ <u>161,255,459</u> | \$ <u>67,982,129</u> | \$ <u>355,676,866</u> |
| EXPENDITURES & TRANSFERS-OUT BY FUND | | | | | | | |
| General Fund | \$ 4,438,679 | \$ 4,807,258 | \$ 101,591,981 | \$ 3,013,991 | \$ 20,240,586 | \$ 999,951 | \$ 135,092,446 |
| State Special Revenue Fund | 146,097 | 351,610 | 8,842,650 | | 69,371,953 | 303,778 | 79,016,088 |
| Federal Special Revenue Fund | 176,965 | 92,400 | | | | | 269,365 |
| Capital Projects Fund | | | 158,290 | | | | 158,290 |
| Enterprise Fund | | 784,625 | 30,930 | 65,188 | | 66,678,400 | 67,559,143 |
| Internal Service Fund | | 156,934 | | | | | 156,934 |
| Private Purpose Trust Fund | | 1,781,680 | | | 36,732 | | 1,818,412 |
| Permanent Fund | | | | | 71,606,188 | | 71,606,188 |
| Total Expenditures & Transfers-Out | 4,761,741 | 7,974,507 | 110,623,851 | 3,079,179 | 161,255,459 | 67,982,129 | 355,676,866 |
| Less: Nonbudgeted Expenditures & Transfers-Out | | 1,781,177 | 8,506,043 | | 72,019,044 | 750,755 | 83,057,019 |
| Prior Year Expenditures & Transfers-Out Adjustments | 322 | (175) | 127,301 | (179) | 1,343,692 | 2,633 | 1,473,594 |
| Actual Budgeted Expenditures & Transfers-Out | 4,761,419 | 6,193,505 | 101,990,507 | 3,079,358 | 87,892,723 | 67,228,741 | 271,146,253 |
| Budget Authority | 5,810,450 | 6,998,151 | 104,978,330 | 3,267,331 | 88,634,610 | 73,403,210 | 283,092,082 |
| Unspent Budget Authority | \$ <u>1,049,031</u> | \$ <u>804,646</u> | \$ <u>2,987,823</u> | \$ <u>187,973</u> | \$ <u>741,887</u> | \$ <u>6,174,469</u> | \$ <u>11,945,829</u> |
| UNSPENT BUDGET AUTHORITY BY FUND | | | | | | | |
| General Fund | \$ 20,706 | \$ 12,185 | \$ 1,376,740 | \$ 4,608 | \$ 31,208 | \$ 5,308 | \$ 1,450,755 |
| State Special Revenue Fund | | 5,500 | 1,517,528 | | 710,679 | 16,438 | 2,250,145 |
| Federal Special Revenue Fund | 1,028,325 | 785,799 | 93,553 | 183,365 | | 97,296 | 2,188,338 |
| Capital Projects Fund | | | 2 | | | | 2 |
| Enterprise Fund | | | | | | 6,055,427 | 6,055,427 |
| Internal Service Fund | | 1,162 | | | | | 1,162 |
| Unspent Budget Authority | \$ <u>1,049,031</u> | \$ <u>804,646</u> | \$ <u>2,987,823</u> | \$ <u>187,973</u> | \$ <u>741,887</u> | \$ <u>6,174,469</u> | \$ <u>11,945,829</u> |

This schedule is prepared from the Statewide Accounting, Budgeting, and Human Resources System (SABHRS) without adjustment. Additional information is provided in the notes to the financial schedules beginning on page A-11.

Montana Department of Revenue

Notes to the Financial Schedules

For the Two Fiscal Years Ended June 30, 2006

1. Summary of Significant Accounting Policies

Basis of Accounting

The department uses the modified accrual basis of accounting, as defined by state accounting policy, for its Governmental (General, State Special Revenue, Federal Special Revenue, Debt Service, Capital Projects, and Permanent) fund category. In applying the modified accrual basis, the department records:

Revenues when it receives cash or when receipts are realizable, measurable, earned, and available to pay current period liabilities.

Expenditures for valid obligations when the department incurs the related liability and it is measurable, with the exception of the cost of employees' annual and sick leave. State accounting policy requires the department to record the cost of employees' annual and sick leave when used or paid.

The department uses accrual basis accounting for its Proprietary (Enterprise and Internal Service) and Fiduciary (Agency and Private-Purpose Trust) fund categories. Under the accrual basis, as defined by state accounting policy, the department records revenues in the accounting period when realizable, measurable, and earned, and records expenses in the period incurred when measurable.

Expenditures and expenses may include: entire budgeted service contracts even though the department receives the services in a subsequent fiscal year; goods ordered with a purchase order before fiscal year-end, but not received as of fiscal year-end; and equipment ordered with a purchase order before fiscal year-end.

Basis of Presentation

The financial schedule format is in accordance with the policy of the Legislative Audit Committee. The financial schedules are prepared

Notes to the Financial Schedules

from the transactions posted to the state's accounting system without adjustment.

The department uses the following funds:

Governmental Fund Category

General Fund – to account for all financial resources except those required to be accounted for in another fund.

State Special Revenue Fund – to account for proceeds of specific revenue sources (other than private-purpose trusts or major capital projects) that are legally restricted to expenditures for specific state program purposes. Department State Special Revenue Funds include various earmarked tax accounts and, in fiscal year 2004-05, an account to administer computer system replacement under Chapter 597, Laws of 2003.

Federal Special Revenue Fund – to account for activities funded from federal revenue sources. Department Federal Special Revenue Funds relate to Mineral Royalty audits and New Hire Administration.

Debt Service Fund – to account for accumulated resources for the payment of general long-term debt principal and interest. The department uses this fund for Renewable Resource and CERCLA (Comprehensive Environmental Response, Compensation, and Liability Act of 1980, Public Law 96-510) bonds.

Capital Projects Fund – to account for financial resources used for the acquisition or construction of major capital facilities, other than those financed by proprietary funds or trust funds. The department collects coal severance and cigarette tax revenues in support of the Long-Range Building Program, as well as funding for its tax processing systems.

Permanent Fund – to account for financial resources that are permanently restricted to the extent that only earnings, and not principal, may be used for purposes that support the department's

Notes to the Financial Schedules

programs. The Permanent Funds reported in the accompanying schedules include the Permanent Coal Trust Fund; the Cultural Trust Fund; the Coal Severance Tax Income and Bond funds; the Resource Indemnity Trust and Income Funds; Common School Trust Fund; the Treasure State Endowment, Income, Regional Water System and Regional Water Income Funds; and, for fiscal year 2005-06, the Big Sky Economic Development Funds.

Proprietary Fund Category

Internal Service Fund – to account for the financing of goods or services provided by one department or agency to other departments or agencies of state government or to other governmental entities on a cost-reimbursement basis. The department's Internal Service Fund accounts for bad debt collection activity.

Enterprise Fund – to account for operations (a) financed and operated in a manner similar to private business enterprises, where the Legislature intends that the department finance or recover costs primarily through user charges; (b) where the Legislature has decided that periodic determination of revenues earned, expenses incurred or net income is appropriate; (c) where the activity is financed solely by a pledge of the net revenues from fees and charges of the activity; or (d) when laws or regulations require that the activities' cost of providing services, including capital costs, be recovered with fees and charges rather than with taxes or similar revenues. Department Enterprise Funds include the Liquor Division fund.

Fiduciary Fund Category

Private-Purpose Trust Fund – to account for activity of any trust arrangement not properly reported in a pension fund or investment trust fund where the principal and income benefit individuals, private organizations, or other governments. Department private-purpose trust funds are used to account for unclaimed property, escheat property, and unlocated mineral owners.

Agency Fund – to account for resources held by the state in a custodial capacity. Agency funds may be used on a limited basis for internal (to the State) clearing account activity but these must have a

Notes to the Financial Schedules

zero balance at fiscal year-end. The department uses agency funds as clearing accounts to facilitate the distribution of receipts from one-stop licensing, county collections, bad debt collections, dishonored checks, Automated Clearing House (ACH) collections, receivables, and gas and oil taxes.

2. General Fund Balance

The department has authority to pay obligations from the statewide General Fund within its appropriation limits. The department's total assets placed in the fund exceed outstanding liabilities, resulting in positive ending General Fund balances for each of the fiscal years ended June 30, 2005, and June 30, 2006. These balances reflect the results of the activity of the department and not the fund balance of the statewide General Fund.

3. Direct Entries to Fund Balance

Direct entries to fund balances in the General, State Special Revenue, Debt Service, Capital Projects, Private-Purpose Trust, and Permanent Funds primarily include entries generated by the state's accounting system to reflect the flow of resources within individual funds shared by separate agencies. Direct entries to fund balance in the Agency Fund for the fiscal year ended June 30, 2006, includes the correction of an error from a previous period that occurred at least two fiscal years prior. Direct entries to fund balances in the Federal Special Revenue and Enterprise Funds for fiscal year ended June 30, 2005, reflect the transfer of Unemployment Insurance funds to the Department of Labor and Industry, effective July 1, 2004.

4. Prior Year Activity

Prior Year Revenues & Transfers-In Adjustments in the General Fund on the Schedules of Changes in Fund Balances & Property Held in Trust for the fiscal years ended June 30, 2006, and 2005, are related to accruals and subsequent adjustments for the differences between actual and estimated collections and for refunds.

5. Nonbudgeted Activity

Nonbudgeted activity in the Permanent Fund on the Schedules of Changes in Fund Balances & Property Held in Trust for the fiscal years ended June 30, 2006, and 2005, is related to coal tax transfers made in accordance with state law.

6. Program Changes

During fiscal year 2005-06, the department reorganized, resulting in a change in expenditure programs. Liquor distribution from the Resource Management Division and liquor licensing from the Customer Service Division were moved into the Liquor Control Division. The human resources function was moved from the Resource Management Division to the Director's Office. The Processing and Retentions Operations unit was moved from the Resource Management Division to the Information Technology and Processing Division. The Customer Service Division was eliminated and its remaining functions were combined into the Citizen Services and Resource Management Division, Information Technology and Processing Division, and Business and Income Taxes Division.

7. System Replacement Funding

Chapter 597, Laws of 2003, required the department to begin replacement of its Process Oriented Integrated System (POINTS). The legislation authorized funding for a replacement system not to exceed \$17 million. Under the provisions of this legislation, the department entered into a loan agreement with the Montana Board of Investments to borrow money from the Permanent Coal Tax Trust Fund. The loan activities are accounted for in the State Special Revenue Fund, as required by Chapter 597, Laws of 2003.

As of June 30, 2004, the department had drawn \$5,886,467 on the loan and repaid \$188,025 of principal. During fiscal year 2004-05, the department drew an additional \$8,738,505 and incurred \$303,439 interest on the loan. The department transferred \$1,108,754 of income tax revenues from the General Fund to the State Special Revenue Fund to make the required principal (\$927,780) and interest (\$180,974) payments in August 2004 and February 2005. In June 2005, the department transferred \$13,664,799 (using supplemental budget authority provided in Chapter 295, Laws of 2005) from the General Fund to the State Special Revenue Fund, from which it paid the remaining principal (\$13,509,167) and interest (\$155,632) on the loan. The remaining costs of developing the replacement system (Integrated Revenue Information System, or IRIS) have been funded through legislative appropriations.

Notes to the Financial Schedules

8. Revenues Over (Under) Estimate

The Schedule of Revenues and Transfers-In for the fiscal year ended June 30, 2005, reports actual tax revenues over the estimate by \$114,643,731 in the General Fund and \$72,306,541 in the State Special Revenue Fund. The General Fund amount is primarily attributable to three tax types exceeding recorded estimates: individual income taxes by \$58,201,557, combined oil and gas taxes by \$35,926,939, and corporation taxes by \$24,765,043. The State Special Revenue Fund amount is primarily attributable to three tax types exceeding recorded estimates: combined oil and gas taxes by \$37,945,391, cigarette taxes by \$13,673,979, and property taxes by \$11,858,106.

The Schedule of Revenues and Transfers-In for the fiscal year ended June 30, 2006, reports actual tax revenues over the estimate by \$78,758,197 in the General Fund and actual investment earnings under the estimate by \$42,493,470 in the Permanent Fund. The General Fund amount is primarily attributable to two tax types exceeding recorded estimates: corporation taxes by \$59,374,693 and individual income taxes by \$19,204,118. The Permanent Fund amount is primarily attributable to a drop in the value of investments in bonds due to increases in interest rates.

9. Unspent Budget Authority

The Schedule of Expenditures and Transfers-Out for the fiscal year ended June 30, 2006, reports Unspent Budget Authority in the State Special Revenue Fund of \$25,929,082, most of which is authority remaining from statutory appropriations.

10. Agency Fund

In fiscal year 2005-06, the department made program code adjustments for Property Held in Trust balances from prior fiscal years. The program code adjustments, for which there was no related cash activity, comprise \$1,957,224 of the Additions and Reductions to Property Held in Trust reported on the Schedule of Changes in Fund Balances & Property Held in Trust for the fiscal year ended June 30, 2006.

11. Loss Contingencies

Certain companies have protested approximately \$12 million in state and local property taxes, which have been included as revenue or fund

Notes to the Financial Schedules

balance on the department's financial schedules as of June 30, 2006. The department had \$5,758,595 in the State Special Revenue Fund at June 30, 2006, that was available for refunds of centrally assessed protested property taxes. Other refunds of protested property taxes would come from the university millage State Special Revenue Fund or from the General Fund.

Certain corporations have requested refunds that are not reported on the department's financial schedules as of June 30, 2006. The corporations have appealed the department's decision to not refund the requested amounts. The refund amounts at issue at June 30, 2006, which would be paid from the General Fund if litigation is settled in favor of the corporations, total \$6,000,000.

Department Response



Dan Bucks
Director

Montana Department of Revenue



Brian Schweitzer
Governor

October 19, 2006

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LEGISLATIVE AUDIT DIV.

Scott A. Seacat, Legislative Auditor
Legislative Audit Division
Room 160, State Capitol
P.O. Box 201705
Helena, MT 59620-1705

Dear Mr. Seacat:

We appreciate the opportunity to respond to the recommendations raised in the Financial Compliance Audit Report of the Montana Department of Revenue for the fiscal years ended June 30, 2005 and 2006. Our response to the recommendations included in the audit report is as follows:

Recommendation #1

We recommend the department implement controls to ensure daily reconciliations of receipts to amounts recorded on its taxpayer systems are complete and accurate.

Concur. The Processing and Retention Operations (PRO) area has already started making changes to comply with this recommendation. We have improved our form layouts for reconciliation to SABHRS and reconciliation for deposit collections. The new form layout contains the necessary fields to track payment information received from various sources and tracks daily and month-to-month reconciliations.

A quality assurance step has since been implemented in which the team lead and unit manager verify totals on a weekly and monthly basis and ensure the accuracy and completion of reports. The cashiering unit will also work with the accounting staff in the Citizen Services and Resource Management Division for a periodic review of the daily reconciliations. This will provide an independent review of the process and a means to recommend any improvements.

A daily checklist for money not reconciled has since been created so staff will know the appropriate steps to locate and/or correct discrepancies. This process will supplement the quality assurance step previously described.

Our training plan is also being evaluated for new employees who have responsibility for daily reconciliation of payments and with plans for more thorough cross training by the end of October 2006.

Finally, we will update our desktop instructions by November 2006 and continue to make form layout improvements as necessary.

Recommendation #2

We recommend the department record revenues and expenditures for local government reimbursements and collection agency contracts, as required by state law.

Concur. Although there is not an impact to the overall general fund balance on how the net reimbursements to local governments or the transactions with the collection agency were recorded, the department agrees the expenditures associated with these transactions should be recorded on the financial records to be in accordance with generally accepted accounting principles. This would require 40-mill property tax revenues to be grossed-up by the local government reimbursements retained by the counties and a reimbursement expense recorded for the same amount. By statute, 15-1-112, MCA, county treasurers are directed to reduce the 40-mill property tax revenues they remit to the state by the reimbursement due to revenue losses resulting from reductions in the Class 8 business equipment tax. This net amount received from counties on the county collection reports is what has been recorded on the state's financial records. The local government reimbursement is completely phased-out in fiscal year 2008.

The department collection agency contract to collect delinquent bad debts was terminated at the end of fiscal year 2005; therefore, the recording of gross revenues and a related commission expense is no longer an issue. The department worked with the legislative appropriations committee to resolve this matter and subsequently ended the contract early as a result of this recommendation in the prior financial compliance audit. In fiscal year 2005 gross revenue collections of \$2,546,831 were realized from this contract. The department recorded these revenues net of the commission expense. To be in compliance with generally accepted accounting principles the department should have recorded an additional \$482,943 in revenues and an offsetting commission expense for the same amount.

The department is seeking legislation to clearly provide the authority to engage individual attorneys and related tools to collect from delinquent out-of-state accounts in selected cases. The department will be asking for a statutory appropriation for out-of-state collections expenses so that expenditures and revenues can be correctly recorded in accordance with this recommendation.

Recommendation #3

We recommend the department:

- A. Charge the General Fund a proportionate share of debt collection program costs for collecting child support debt.

Partially Concur. The department did not charge the general fund a proportionate share of the costs incurred by the debt collection program related to collection of child support debt. The department charged a minimal amount of costs to the general fund based upon its interpretation of section 17-2-108(1), MCA. This statute states "an office or entity of the executive... branch of state government shall apply expenditures against appropriated non-general fund money whenever possible before using general fund appropriations". In the future the department will apply a proportionate share of child support debt collection costs to the general fund appropriation.

- B. Adjust its delinquent account collection rate to be commensurate with costs, in accordance with state law.

Concur. The department budget request for the 2009 biennium includes a reduced delinquent account collection rate. The current rate of 10% will be reduced to 5%.

The department recently conducted an analysis of the internal service fund to determine the delinquent account collection rate to request for the 2009 biennium. To establish a rate that is commensurate with the costs of the debt collection unit, the current fund balance and estimated revenues and expenses for the next biennium were considered.

Based on this analysis and a reduced collection rate, staff expects the existing fund balance to decrease and the collections to be commensurate with costs. This analysis and the reduced collection rate of five percent to be requested is based on the continuation of the HB2 biennial, general fund appropriation of \$147,460 to cover collection costs related to collection of child support debt.

The 2005 Legislature significantly changed the funding for the debt collection program by not allowing commission fees to be charged on child support debt collected. Instead, the legislature appropriated general fund for costs related to child support debt collection. By not collecting a commission on these debts the debt collection unit recovers less in revenues. After the existing fund balance is spent down to a nine month working capital balance; therefore, it is likely a debt collection rate greater than 5% will be necessary subsequent to the 2009 biennium to recover costs of the program.

- C. Move \$36,662 of fiscal year 2005-06 costs from the Internal Service Fund to the General Fund.

Concur. The department will move \$36,662 of fiscal year 2006 costs from the Internal Service Fund to the General Fund. This accounting entry is contingent on the Office of Budget and Program Planning approving a budget change document to establish prior year general fund appropriation authority, as the unspent authority carried forward to fiscal year 2007.

Recommendation #4

We recommend the Department of Revenue work with the Board of Oil and Gas Conservation to develop and implement procedures for cross-matching oil and gas production and sales data to ensure all oil and gas severance taxes owed are reported or assessed in accordance with state law.

Partially Concur. The department agrees to work with the Board of Oil and Gas Conservation (BOGC) on the development and implementation of a process to systemically cross-match BOGC well data with department tax data. To accomplish this, the department will: 1) work with BOGC on the development of the data requirements to conduct the cross-match; 2) enter into an MOU with BOGC which will contain the data requirements, timelines and responsibilities; and 3) work with the department's programming staff to develop electronic non-filer and/or missing lease letters. It is anticipated this process will be in place by the end of 2007.

The audit noted the department was not complying with the provision of 15-36-313 (1), MCA, which requires the immediate issuance of an estimated tax assessment for operators who have failed to file an oil and gas production tax return. The department believes that while estimated tax assessments are a useful enforcement tool, there are more efficient and effective ways to enforce compliance. These other enforcement tools include issuing administrative subpoenas and orders to show cause for non-filing. The department intends to continue to use estimated tax assessments when appropriate, but will be focusing on enforcement by using these other tools. To specifically address the audit findings, the department will seek legislation to strike the requirement to immediately issue an estimated assessment. The proposed legislation will continue to give the department the authority to issue estimated assessments when appropriate.

Recommendation #5

We recommend the department:

- A. Work with the Secretary of State to obtain the information necessary for an efficient comparison of new entity information.

Concur. The department is working with the Secretary of State in order to receive approximately seven additional files which will include data the department has been missing. This process is limited to an initial comparison by name only. In order to make this an efficient process; however, the Secretary of State would need to require a taxpayer identification number; i.e., federal employer identification number or social security number which they do not currently require. Otherwise, the comparison process has marginal value.

In the June 2006 Performance Audit titled "Improving Taxpayer Compliance in Montana Through Audit Efforts" the Legislative Auditor recommended that the department:

Establish priorities for achieving audit goals and objectives, and more effectively deploy audit resources by directing audit activities. The department will continue to work with data provided by the Secretary of State. As long as SSN/FEIN numbers are not required by the legislature or the Secretary of State; however, this data will likely have marginal value and will not be assigned as high a priority for compliance use as other data that can be cross-matched on a more efficient and effective basis.

- B. Compare information to department records for all of the entities the Secretary of State reports.

Concur. The department will continue to compare department records with the information the Secretary of State reports. However, as previously mentioned, this is currently an inefficient process as there is not a taxpayer identification number included in these reports. The department will work with the Secretary of State's office to see if they can revise their process to capture a taxpayer identification number.

- C. Implement more effective procedures for identifying and reporting corporation license tax nonfilers and delinquent filers to the Secretary of State as required by state law.

Concur. The department will work toward implementing more effective procedures to identify and report corporation license tax non-filers and delinquent filers to the Secretary of State as required by state law. As previously described this process is limited and inefficient without a common taxpayer identification number to compare data against. A common denominator is necessary to make this exchange of information a worthwhile exercise.

Recommendation #6

We recommend the department:

- A. Comply with section 15-30-112, MCA, concerning the income limitation of dependents other than taxpayers' children.

Concur. The \$800 income limitation has been included in the instructions within the 2006 individual income tax booklet to comply with current law. The department will seek legislation to apply the inflation factor to the \$800 income limitation in future tax years to be consistent with how the department applies the inflation factor to the exemptions provided for in this section of law.

- B. Improve the tax booklet by including all information affecting individual income tax computations contained in state law.

Concur. Sections 15-30-105(2), 15-30-121(1)(i), and 15-30-106, MCA, identified in the audit as laws not included in the 2005 individual income tax booklet have been included in the 2006 tax year booklet. The department is reviewing what can be done to improve

the instructions for someone preparing a return for a taxpayer that is unable to prepare their own as described in 15-30-142(3), MCA. Based on this review, any recommended changes will be included in the 2006 tax year booklet providing that changes can still be made to meet the printing deadlines. If changes to the 2006 tax year booklet cannot be made the recommended improvements will be included in the 2007 tax year booklet.

Recommendation #7

We recommend the department:

- A. Centrally assess cellular phone companies as required by section 15-23-101, MCA.

Concur. The department will conduct interest group meetings with interested parties to move forward with implementing this recommendation. The interested parties will include local and state government as well as affected taxpayers. The discussion will seek the parties' thoughts on such items as implementation timelines, valuation methodology and revenue impacts. The department will begin this process with the intention of implementing the recommendation for the 2007 tax year, while allowing at the same time an opportunity for the 2007 legislative session to review the issue.

- B. Implement procedures and administrative rules to provide consistency in assessing additional penalties for purposely failing to file or pay taxes when due, as required by sections 15-1-216(1)(b) and (1)(d), MCA.

Concur. The department agrees with the recommendation that a consistent approach to assessing penalty and interest for purposely failing to file or pay taxes when due should be taken. To a large degree this consistency will happen through the change in statute which will occur on January 1, 2007. Beginning January 1, 2007 the definition in 15-1-216, MCA, for the penalty and interest provisions applying to purposely failing to file or pay taxes when due will be specifically defined. The department will review the new language to determine if any additional clarity is needed. If so, the department will adopt the appropriate clarity through administrative rule. The department is also proposing legislation to address some of the penalty deficiencies in the current statute. Some of these changes include stricter penalties for non-reporting, non-payment and fraud.

- C. Seek legislation to amend sections 15-1-201 and 15-35-104, MCA, to reflect the department's current information needs from municipal corporations and coal mine operators.

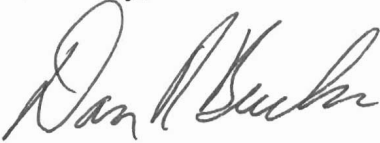
Concur. The department will assess its current information needs from municipal corporations and coal mine operators and seek the necessary changes to existing statute through a general tax revision bill. The language in section 15-1-201(3), MCA, as currently written requires the department to collect specific information from municipal corporations annually, although the department does not deem all of the

information cited as necessary and helpful in performing the work of the department. The department; therefore, will seek legislation to make the statute less restrictive and allow the department to request information as deemed necessary.

The department will also propose legislation to eliminate the requirement in 15-35-104, MCA, for coal mine operators to provide a statement of the tons of coal sold to each purchaser by quarter. This information is no longer required for the enforcement or collection of the coal severance tax.

We appreciate the professionalism demonstrated by your staff that participated in the audit. Thank you again for the opportunity to review the audit report and respond to the recommendations included therein.

Sincerely,

A handwritten signature in dark ink, appearing to read "Dan Bucks", written in a cursive style.

Dan Bucks, Director